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Insights

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While the word “stagflation” has entered the daily vernacular of capital market participants, those with a deeper understanding of the economic phenomena impacting the planet understand that stagflation is as far from the realm of the possible as one can imagine. In this week’s commentary, we provide our latest insights from the Milken Institute’s global conference, which we attended in Los Angeles.

Looking for Solutions to Global Economic Problems? Look West

Last week we attended the Milken Institute Global Conference in Los Angeles. Today we share with you insights from this event.

The Milken Institute is a not-for-profit independent think tank. For the last eight years, they have held a three-day conference at their offices in California to discuss problems faced by the global economy. They invite academics, Nobel laureates, US policy makers, foreign officials, CEOs, and entrepreneurs to attend. The conference is a kind of mini-Davos, but instead of being located in Switzerland’s neutral territory, it’s on America’s West Coast. We can’t help but wonder if this is not a better location for actually finding solutions to our problems: On the historical timeline, innovation flows from West to East.

This year’s conference attracted 2200 participants from around the globe. The conference theme was “Building a Prosperous Future,” and it included topics on finance, healthcare, education, industries, regions, and the media. The goal of the conference (and of the Milken Institute) is to improve the planet’s human capital — the talent, knowledge, and experience of people and their value to organizations, economies, and society — using market-based innovations to make a better and more prosperous world. In effect, the conference is about lifelong learning. It is not about politics and instead strives to debate the major issues and come up with solutions.

The opening session, Global Overview: Building a Prosperous Future, included panelists Gary S. Becker, 1992 Nobel Memorial Prize laureate in economic sciences; Wesley Clark, former NATO commander and presidential candidate; and Rupert Murdoch, CEO of News Corporation. Paul Gigot, editorial-page editor for *The Wall Street Journal*, was the moderator, and thus was the pattern of the entire conference: left meeting right, conservative meeting liberal. On the economy, Gary Becker was not surprised by last year’s 4% growth rate in the United States. He expects the same this year with higher-than-expected productivity gains at the root of the strong growth. He said that the United States is only at the beginning of a cycle that will benefit from the innovations of the last decade (we concur strongly on this). Just back from lecturing in Paris, he believes Europe will not change its ways even though it understands that workforce rigidities are preventing faster growth. He thinks the Indian and Chinese economies will continue to grow rapidly, a different take on the usual doom and gloom. All of the panelists were surprised that oil prices are not having a more negative impact on US consumers. They also agreed that given the current turmoil in Chinese/Japanese relations, it is a good time for the United States to reassert its leadership role in the region. While the panel acknowledged that our twin budget and trade deficits were a cause of concern, they didn’t want to exaggerate their impact on US growth (hear, hear!). Neither were they afraid that China’s economic prowess would dwarf the United States, agreeing that China’s weakest links were its distressed debt and fragile banking system. The biggest surprise from China may be that it continues to grow at double-digit rates for the foreseeable future with no bumps in the road and no economic busts.

In the sessions on healthcare reform, there seemed to be a consensus among the CEOs present that no change in the current system would take place without a partnership between management and employees. Employees need to recognize that they are in control of how they live their lives and treat their bodies and that their choices have an impact on the cost of healthcare. All agreed that this is a leadership issue that demands change at the top in order to be effective and that incentives alone will not work to change the ever-growing course of healthcare spending in the United States. In the general session Bits, Biology & Bionics: Medicine in 2025, the panel included J. Craig Venter, founder and president of the J. Craig Venter Science Foundation and mapper of the human genome; Ray Kurzweil, inventor, entrepreneur, author, and futurist; and David J. Brailer, the national coordinator for Health Information Technology. Kurzweil said that we are on the path toward rational drug design where — through a combination of science and technology — we will be able to see what happens inside human cells and aggressively slow the course of diseases such as heart disease and cancer. He predicts (and we should mention that many of his forecasts have come true) that within 30 years we'll be able to reprogram and reverse the destruction of cells and thus extend life.

Venter said that eventually we'll be able to map our individual genomes for less than $1000. While exploring our genetic vulnerability to certain diseases is interesting, he said, the genetic probability of getting cancer, for example, is small since nearly 70% of all cancers are caused by environmental changes to our genes. He said we need to move our healthcare system away from "reactive" medicine toward "predictive" and "preventive" medicine. He also said that we need to bring new people in on the project of understanding genes, making it an interdisciplinary project and bringing all kinds of intelligence to bear on gaining more insight.

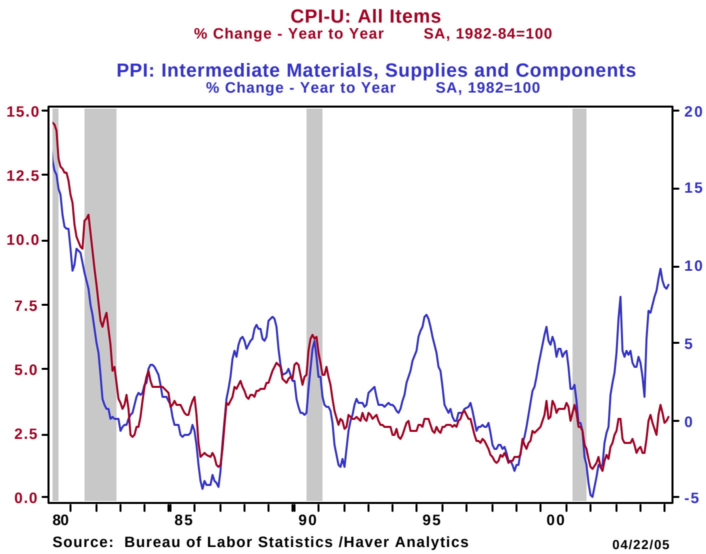
David Brailer said that digitizing medical records would cost the United States $50 billion to $250 billion. He said the Bush administration's goal is for individuals to choose their own healthcare options and control them.

On the Social Security panel, there were unfortunately no new innovation solutions to share that have not been discussed elsewhere. The conclusion is that changes to the current system will cause pain for some segments of the population. The panelists agreed that embracing ideological positions is not a solution — parties need to work together and currently they aren't doing that well. All agreed that the solution would involve more saving on the part of Americans, whether forced or not, through 401(k) plans.

Financial Innovations: Market Solutions to Global Challenges included panelists Lewis Ranieri, Myron Scholes, Richard Sandor, and Michael Milken. Readers will remember that these individuals are the fathers of the modern mortgage-backed securities, options, and junk bond markets. Issues discussed included bringing low-cost mortgages to the rest of the world. The panelists believe that this is possible in countries with a rule of law that would allow working with the government to bring it about. Owning one's own house is the first step on the path to an ownership society and wealth accumulation. The panel believes that this is every individual's right.

Tapping Opportunity in the Developing World: Innovative Solutions for Companies and Communities was an innovative panel dealing with the issue of global poverty. On this panel, we listened to C.K. Prahalad, University of Michigan business school professor and author of *The Fortune at the Bottom of the Pyramid: Eradicating Poverty through Profits*. In this book, Prahalad proposes a new business paradigm for multinational companies. With 80% of the people in the world below their radar screen, he suggests viewing the poor as "willing participants in the race to get out of poverty." He explained that while multinationals are struggling with organic growth, the poor want to get aboard the global capitalism bandwagon. They want to become consumers, they want to have assets, and they want to own their own houses. Prahalad suggests building a bridge between the poor and the multinationals, where consumers, firms, and social groups are all winners. The old model of redistributing wealth from rich nations to poor nations through NGOs is broken — the oil-for-food scandal brought that to light. We need new solutions to a very old problem. This was one of the more interesting panels for us. We believe all humans want the dignity of earning wages and taking care of their families. They do not want handouts. They want to participate in the global capitalist system as consumers, savers, investors, and producers. Prahalad agrees with this thinking and believes that change can occur but will involve a dramatic rethinking, a changing of the mental model.

Lastly, there was a fascinating dinner panel entitled Democracy and the Media: Are They Compatible?, at which Mort Zuckerman of the *New York Daily News*; Al Gore, former vice president and presidential candidate; Roger Ailes, chairman and CEO of Fox News; and Jeff Greenfield of CNN discussed the future of the news media in light of new developments such as blogs, which are democratizing the way information is distributed. This force can't be ignored as online communities are being formed at the grassroots level to keep the mainstream media honest. All agreed that we are in the midst of a big shift that will change the business model for media. Look out, shareholders.



This week's inflation measures left market participants talking about old-fashioned stagflation by the end of the week. While it is disconcerting to see headline inflation measures of such magnitude, it is important to remember that an economy like ours is now interwoven in the global economy. The deflationary effects of the global web now envelop the planet. Innovations created during the stock market bubble continue to make their way on a daily basis into the work processes of businesses, bringing nation states ever closer together and preventing inflation from rearing its ugly head. This results in various phenomena such as outsourcing, insourcing, offshoring, supply-chaining, and open-sourcing, which make businesses more efficient and productive, workforces more flexible, and companies more profitable. If you don't understand this, you will fall victim to the latest fad of the day in capital market discussions and you will end up believing that the US economy could actually experience 1970s-style stagflation. But stagflation is as far from the realm of possibility of economic scenarios as one could imagine. We encourage all our readers to pick up a copy of Thomas L. Friedman's *The World Is Flat: a Brief History of the Twenty-first Century* to fully understand what has happened in the last 15 years. After reading it, read it again.

In the meantime, local businesses will continue to feel the impact of $50-per-barrel oil and will gradually raise the prices of the services they provide as long as the market will bear it. We continue to believe the Fed will stop tightening at 3.5% this summer.

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